

**KIARO BRANDS INC.**

Condensed Consolidated Interim Financial Statements

For the three and six months ended July 31, 2020  
and the three and seven months ended July 31, 2019

(Expressed in Canadian Dollars)

**KIARO BRANDS INC.**

## Condensed Consolidated Interim Statements of Financial Position

As at July 31, 2020 and January 31, 2020

(Unaudited)

|   | Notes | July 31, 2020      | January 31, 2020  |
|---|-------|--------------------|-------------------|
| <b>ASSETS</b>                                     |       |                    |                   |
| <b>Current assets</b>                             |       |                    |                   |
|   |       | \$                 | \$                |
| Cash and cash equivalents                         |       | 992,408            | 1,418,764         |
| Trade and other receivables                       | 4     | 140,348            | 162,460           |
| Prepays and deposits                              | 5     | 99,442             | 207,912           |
| Inventory   | 6     | 1,371,091          | 841,829           |
| Investment in marketable securities               | 7     | -                  | 2,986,518         |
| Loan receivable                                   | 8     | -                  | 297,382           |
| Net investment in finance lease                   | 10    | 181,932            | 130,483           |
|   |       | <u>2,785,221</u>   | <u>6,045,348</u>  |
| <b>Non-current assets</b>                         |       |                    |                   |
| Lease deposits                                    | 5     | 109,514            | 183,742           |
| Property and equipment                            | 9     | 1,904,023          | 1,749,072         |
| Right-of-use assets                               | 10    | 4,170,813          | 4,944,646         |
| Net investment in finance lease                   | 10    | 367,038            | 460,908           |
| Intangible assets and goodwill                    | 11    | 608,588            | 608,588           |
|   |       | <u>7,159,976</u>   | <u>7,946,956</u>  |
| <b>TOTAL ASSETS</b>                               |       | <b>9,945,197</b>   | <b>13,992,304</b> |
| <b>LIABILITIES</b>                                |       |                    |                   |
| <b>Current liabilities</b>                        |       |                    |                   |
| Accounts payable and accrued liabilities          |       | 1,998,340          | 1,462,426         |
| Due to related parties                            | 14    | 1,246              | 18,861            |
| Current portion of lease liabilities              | 10    | 676,194            | 683,979           |
| Current portion of purchase liability             |       | 296,315            | 370,180           |
| Current portion of long-term liabilities          | 12    | 226,664            | 694,055           |
|   |       | <u>3,198,759</u>   | <u>3,229,501</u>  |
| <b>Non-current liabilities</b>                    |       |                    |                   |
| Long-term portion of lease liabilities            | 10    | 1,865,630          | 2,487,121         |
| Long-term portion of purchase liability           |       | -                  | 103,230           |
| Embedded derivative liabilities                   | 12    | 1,695,787          | 1,285,000         |
| Long-term liabilities                             | 12    | 5,741,847          | 5,836,712         |
|   |       | <u>9,303,264</u>   | <u>9,712,063</u>  |
| <b>TOTAL LIABILITIES</b>                          |       | <b>12,502,023</b>  | <b>12,941,564</b> |
| <b>Equity attributable to shareholders</b>        |       |                    |                   |
| Share capital                                     | 13    | 15,386,373         | 14,987,041        |
| Reserves  | 13    | 2,433,819          | 1,186,081         |
| Accumulated deficit                               |       | (20,377,018)       | (15,122,382)      |
| <b>TOTAL EQUITY</b>                               |       | <u>(2,556,826)</u> | <u>1,050,740</u>  |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> |       | <b>9,945,197</b>   | <b>13,992,304</b> |

Going concern (Note 1)

Commitments and contingencies (Note 17)

Subsequent events (Note 19)

(The accompanying notes are an integral part of these condensed consolidated interim financial statements)

On behalf of the board:

"Daniel Petrov"

Daniel Petrov

**KIARO BRANDS INC.**

## Condensed Consolidated Interim Statements of Loss and Comprehensive Loss

For the Three and Six Months Ended July 31, 2020 and the Three and Seven Months Ended July 31, 2019  
(Unaudited)

|   |       | Three months ended |                    | 6 months ended     | 7 months ended     |
|---|-------|--------------------|--------------------|--------------------|--------------------|
|   | Notes | July 31, 2020      | July 31, 2019      | July 31, 2020      | July 31, 2019      |
| <b>Revenue</b>                                  |       | \$                 | \$                 | \$                 | \$                 |
| Revenue   |       | 4,000,102          | 779,316            | 6,666,813          | 1,279,997          |
| Cost of sales                                   |       | 2,763,856          | 562,214            | 4,715,282          | 899,229            |
| Gross profit                                    |       | 1,236,246          | 217,102            | 1,951,531          | 380,768            |
| <b>Operating expenses</b>                       |       |                    |                    |                    |                    |
| Consulting                                      |       | 126,735            | 412,999            | 179,980            | 626,656            |
| Depreciation and amortization                   | 9,10  | 474,623            | 597,849            | 768,538            | 884,960            |
| Maintenance                                     |       | 50,926             | 67,517             | 86,833             | 142,875            |
| Marketing and brand development                 |       | 64,133             | 190,469            | 98,616             | 426,128            |
| Meals and entertainment                         |       | 238                | 6,700              | 1,673              | 19,278             |
| Office and administration                       |       | 136,490            | 125,465            | 283,908            | 363,820            |
| Professional fees                               |       | 174,550            | 132,932            | 358,891            | 263,626            |
| Salaries and employee benefits                  | 13    | 817,943            | 906,672            | 1,564,638          | 1,802,801          |
| Share-based compensation                        | 13    | 244,222            | 24,081             | 640,304            | 68,289             |
| Travel  |       | 1,594              | 37,497             | 7,371              | 94,815             |
| Inventory write-down                            | 6     | -                  | -                  | 19,188             | -                  |
|   |       | 2,091,454          | 2,502,181          | 4,009,940          | 4,693,248          |
| <b>Other (expenses) income</b>                  |       |                    |                    |                    |                    |
| Change in fair value of derivative liabilities  | 12    | (2,382)            | 27,855             | (25,883)           | 27,855             |
| Lease termination loss and loss on sublease     | 10    | (1,788)            | (17,110)           | (55,210)           | (17,110)           |
| Loss on modification and extinguishment of debt | 12    | (93,344)           | -                  | (93,344)           | -                  |
| Foreign exchange gain                           | 7     | -                  | -                  | 38,413             | -                  |
| Finance income                                  |       | 45,866             | 18,617             | 45,866             | 35,278             |
| Finance expense                                 | 10,12 | (536,949)          | (374,767)          | (1,000,521)        | (489,612)          |
| Realized loss on sale of marketable securities  | 7     | -                  | -                  | (2,105,548)        | -                  |
|   |       | (588,597)          | (345,405)          | (3,196,227)        | (443,589)          |
| <b>Net loss and comprehensive loss</b>          |       | <b>(1,443,805)</b> | <b>(2,630,484)</b> | <b>(5,254,636)</b> | <b>(4,756,069)</b> |
| <b>Loss per share, basic and diluted</b>        |       | <b>(0.01)</b>      | <b>(0.13)</b>      | <b>(0.05)</b>      | <b>(0.25)</b>      |

(The accompanying notes are an integral part of these condensed consolidated interim financial statements)

**KIARO BRANDS INC.**

Condensed Consolidated Interim Statement of Changes in Shareholders' Equity  
 For the Six Months Ended July 31, 2020 and the Seven Months Ended July 31, 2019  
 (Unaudited)

|  | Notes | Share Capital     |                   | Long-Term         |                     |                | Total Equity     |                     |                    |
|--|-------|-------------------|-------------------|-------------------|---------------------|----------------|------------------|---------------------|--------------------|
|  |       | Common Shares     | Preferred Shares  | Liability Reserve | Contributed Surplus | Deficit        |                  |                     |                    |
|  |       | #                 | \$                | #                 | \$                  | \$             | \$               |                     |                    |
| Balance on December 31, 2018                         |       | 16,344,600        | 8,720,363         | -                 | -                   | 92,379         | 318,000          | (2,619,132)         | <b>6,511,610</b>   |
| Elora shares issued for cash                         |       | 3,402,110         | 83,495            | -                 | -                   | (92,379)       | -                | -                   | <b>(8,884)</b>     |
| Founders' convertible debenture                      |       | 600,000           | 353,348           | -                 | -                   | -              | -                | -                   | <b>353,348</b>     |
| Bonus shares issued                                  |       | 5,000             | 5,000             | -                 | -                   | -              | -                | -                   | <b>5,000</b>       |
| Kiara shares issued for cash                         |       | 68,000            | 68,000            | -                 | -                   | -              | -                | -                   | <b>68,000</b>      |
| Share based compensation                             |       | -                 | -                 | -                 | -                   | -              | 68,289           | -                   | <b>68,289</b>      |
| Net loss and comprehensive loss for the period       |       | -                 | -                 | -                 | -                   | -              | -                | (4,756,068)         | <b>(4,756,068)</b> |
| <b>Balance on July 31, 2019</b>                      |       | <b>20,419,710</b> | <b>9,230,206</b>  | <b>-</b>          | <b>-</b>            | <b>-</b>       | <b>386,289</b>   | <b>(7,375,200)</b>  | <b>2,241,295</b>   |
| Balance on January 31, 2020                          |       | 98,048,458        | 14,987,041        | -                 | -                   | 142,907        | 1,043,174        | (15,122,382)        | <b>1,050,740</b>   |
| Reclass of warrants value on prior issuance          |       | -                 | (509,196)         | -                 | -                   | -              | 509,196          | -                   | <b>-</b>           |
| Shares converted to debentures                       | 12    | (500,000)         | (100,000)         | -                 | -                   | -              | -                | -                   | <b>(100,000)</b>   |
| Warrants issued on convertible loan                  | 12    | -                 | -                 | -                 | -                   | -              | 98,239           | -                   | <b>98,239</b>      |
| Shares issued for services rendered                  | 13    | 445,249           | 76,750            | -                 | -                   | -              | -                | -                   | <b>76,750</b>      |
| Convertible debentures converted to preferred shares | 12,13 | -                 | -                 | 10,000,000        | 931,777             | -              | -                | -                   | <b>931,777</b>     |
| Share based compensation                             | 13    | -                 | -                 | -                 | -                   | -              | 640,304          | -                   | <b>640,304</b>     |
| Net loss and comprehensive loss for the period       |       | -                 | -                 | -                 | -                   | -              | -                | (5,254,636)         | <b>(5,254,636)</b> |
| <b>Balance on July 31, 2020</b>                      |       | <b>97,993,707</b> | <b>14,454,595</b> | <b>10,000,000</b> | <b>931,777</b>      | <b>142,907</b> | <b>2,290,913</b> | <b>(20,377,018)</b> | <b>(2,556,826)</b> |

(The accompanying notes are an integral part of these condensed consolidated interim financial statements)

**KIARO BRANDS INC.**

## Condensed Consolidated Interim Statement of Cash Flows

For the Three and Six Months Ended July 31, 2020 and the Three and Seven Months Ended July 31, 2019  
(Unaudited)

|  | 6 months ended<br>July 31, 2020 | 7 months ended<br>July 31, 2019 |
|--|---------------------------------|---------------------------------|
| Cash provided by (used in):                          |                                 |                                 |
| <b>Operating activities:</b>                         |                                 |                                 |
| Net loss   | \$ (5,254,636)                  | \$ (4,756,069)                  |
| Non-cash items:                                      |                                 |                                 |
| Depreciation and amortization                        | 768,538                         | 884,960                         |
| Share-based compensation                             | 640,304                         | 68,289                          |
| Shares issued for services                           | 76,750                          | -                               |
| Inventory write-down                                 | 19,188                          | -                               |
| Foreign exchange gain                                | (38,413)                        | -                               |
| Finance expense                                      | 908,453                         | 405,422                         |
| Finance income                                       | (45,866)                        | (18,617)                        |
| Change on fair value of embedded derivative          | 25,883                          | (27,855)                        |
| Loss on modification and extinguishment of debt      | 93,344                          | -                               |
| Lease termination loss and loss on sub-lease         | 55,210                          | 17,110                          |
| Realized Loss on sale of Investment                  | 2,105,548                       | -                               |
| Changes in non-cash working capital:                 |                                 |                                 |
| Trade and other receivables                          | 61,772                          | (70,226)                        |
| Prepays and deposits                                 | 137,293                         | (379,268)                       |
| Inventory  | (544,842)                       | (752,771)                       |
| Accounts payable and accrued liabilities             | 204,189                         | (62,921)                        |
|  | (787,285)                       | (4,691,946)                     |
| <b>Investing activities:</b>                         |                                 |                                 |
| Property and equipment                               | (496,054)                       | (1,409,144)                     |
| Proceeds from sale of marketable securities          | 910,183                         | -                               |
| Convertible debenture investments                    | -                               | (300,000)                       |
| Payments towards prior year business combination     | (206,771)                       | (554,693)                       |
|  | 207,358                         | (2,263,837)                     |
| <b>Financing activities:</b>                         |                                 |                                 |
| Due to related parties                               | (23,264)                        | 288,089                         |
| Loan proceeds from CEBA                              | 40,000                          | -                               |
| Loan received from related party                     | 500,000                         | -                               |
| Repayments on loan from related party                | (500,000)                       | -                               |
| Payments received on net investment in finance lease | 124,217                         | -                               |
| Payments on lease obligations                        | (512,382)                       | (1,058,101)                     |
| Loan repayment                                       | (700,000)                       | -                               |
| Proceeds from issuance of convertible debentures     | 1,000,000                       | 4,026,400                       |
| Proceeds from issuance of promissory notes           | 225,000                         | -                               |
|  | 153,571                         | 3,256,388                       |
| Net change in cash and cash equivalents              | (426,356)                       | (3,699,395)                     |
| Cash and cash equivalents, beginning                 | 1,418,764                       | 6,103,354                       |
| <b>Cash and cash equivalents, ending</b>             | <b>\$ 992,408</b>               | <b>\$ 2,403,959</b>             |

See Note 16 for supplemental cash flow

(The accompanying notes are an integral part of these condensed consolidated interim financial statements)

## **KIARO BRANDS INC.**

Notes to the Condensed Consolidated Interim Financial Statements

For the Six Months Ended July 31, 2020 and the Seven Months Ended July 31, 2019

(Expressed in Canadian Dollars)

### **1) NATURE OF OPERATIONS AND GOING CONCERN**

Kiaro Brands Inc. (“Kiaro” or the “Company”) was formed on September 9, 2019, through the amalgamation of Aura Cannabis Inc. (“Aura”) and Elora Capital Ltd. (“Elora”), via an amalgamation agreement entered into on July 24, 2019. Aura was incorporated under the Business Corporation Act of British Columbia on December 11, 2017 and was formed to own and operate cannabis retail stores in various provinces of Canada. Elora was incorporated under the Business Corporation Act of British Columbia on March 13, 2018 and was formed for the primary purpose of identifying and evaluating assets or business with a view of completing a transaction. To effect the Amalgamation, each issued and outstanding Aura share was cancelled and the holder of each Aura share received five common shares of Kiaro; and each issued and outstanding Elora share was cancelled, and the holder of each Elora share received one common share of Kiaro. Following the amalgamation, both Aura and Elora were dissolved.

#### **Going Concern Assumption**

These condensed consolidated interim financial statements for the period ended July 31, 2020, have been prepared on the going concern basis, which assumes that the Company will continue to operate and will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

The Company is in the expansion phase by opening and acquiring cannabis retail locations throughout Canada. While these condensed consolidated interim financial statements have been prepared on a going concern basis, the Company continues to remain dependent on its ability to obtain sufficient funding to sustain operations and continue with its current expansion projects. Several alternatives are being evaluated with the objective of funding ongoing activities and obtaining additional working capital, however, there is no certainty these initiatives will be successful. While the Company has been successful in raising financing in the past, there can be no assurance that it will be able to do so in the future. The continuing operations of the Company are dependent upon its ability to raise adequate financing and to commence profitable operations in the future. The Company has incurred losses and negative cash flows from operations and as at July 31, 2020, has an accumulated deficit of \$20,377,018. These conditions cast a material uncertainty on the Company’s ability to continue as a going concern. The Condensed Consolidated Interim Financial Statements do not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

### **2) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **a) Statement of Compliance**

The condensed consolidated interim financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (“IFRS”) following the guidance International Accounting Standards 34, “Interim Financial Reporting” (“IAS 34”) as issued by the International Accounting Standards Board (“IASB”), and interpretations of the IFRS Interpretations Committee (“IFRIC”).

These condensed consolidated interim financial statements were approved by the Board of Director on September 29, 2020.

## **KIARO BRANDS INC.**

Notes to the Condensed Consolidated Interim Financial Statements  
For the Six Months Ended July 31, 2020 and the Seven Months Ended July 31, 2019  
(Expressed in Canadian Dollars)

### **2) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(continued)*

#### **b) Basis of Presentation and Measurement**

These condensed consolidated interim financial statements have been prepared on a historical cost basis, except for certain financial instruments measured at fair value. In addition, these condensed consolidated interim financial statements have been prepared using the accrual basis of accounting, except for cash flow information and include all adjustments considered necessary for fair presentation by the Company's management.

The Condensed Consolidated Interim Financial Statements are presented in Canadian dollars and are prepared in accordance with the same accounting policies, critical estimates and methods described in the company's annual audited consolidated financial statements for the thirteen months ended January 31, 2020 and the year ended December 31, 2018 (the "Annual Audited Consolidated Financial Statements"). Given that certain information and footnote disclosures, which are included in the annual audited financial statements, have been condensed or excluded in accordance with IAS 34, these financial statements should be read in conjunction with our annual audited consolidated financial statements for the year ended January 31, 2020, including the accompanying notes thereto.

The seven month period from January 1, 2019 to July 31, 2019, is used as the basis for comparison to the current six month period from February 1, 2020 to July 31, 2020. The additional one month on a year to year comparative basis is the result of a change in the fiscal year end from December 31, 2018 to January 31, 2020.

#### **c) Consolidation**

These condensed consolidated interim financial statements include the accounts of the Company and its subsidiaries on a consolidated basis after elimination of intercompany transactions and balances. These condensed consolidated interim financial statements include the operating results of acquired entities from the date control commences until the day control ceases.

The operating subsidiaries the Company has control over are as follows:

| <b>Subsidiaries</b>                 | <b>Ownership</b> |
|-------------------------------------|------------------|
|                                     | %                |
| National Cannabis Distribution Inc. | 100              |
| Kiaro Retail BC Ltd.                | 100              |
| 2209917 Alberta Ltd.                | 100              |

#### **d) Functional and Presentation Currency**

These condensed consolidated interim financial statements are presented in Canadian dollars unless otherwise noted. The presentation currency and functional currency of the Company and its subsidiaries is the Canadian Dollar.

## KIARO BRANDS INC.

Notes to the Condensed Consolidated Interim Financial Statements  
For the Six Months Ended July 31, 2020 and the Seven Months Ended July 31, 2019  
(Expressed in Canadian Dollars)

### 3) NEW AND REVISED STANDARDS

The Company has adopted the following new or amended IFRS standards for the period ended July 31, 2020, which was effective for annual periods beginning on or after January 1, 2020 and are required to be applied prospectively.

#### IAS 1 Presentation of Financial Statements

In October 2018, the International Accounting Standards Board (IASB) issued amendments to IAS 1 which were incorporated into Part I of the CPA Canada Handbook – Accounting by the Accounting Standards Board (AcSB) in February 2019. The amendments clarify the definition of material and how it should be applied, as well as align the definition of material across IFRS standards and other publications. The amended definition of material states:

*Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.*

The adoption of this amendment does not have a material impact on the Company's condensed consolidated interim financial statements.

### 4) TRADE AND OTHER RECEIVABLES

|                   | July 31, 2020 | January 31, 2020 |
|-------------------|---------------|------------------|
|                   | \$            | \$               |
| Trade receivables | 86,247        | 29,992           |
| GST receivable    | 9,472         | 54,610           |
| Other receivables | 44,629        | 77,858           |
|                   | 140,348       | 162,460          |

### 5) PREPAIDS AND DEPOSITS

|                          | July 31, 2020 | January 31, 2020 |
|--------------------------|---------------|------------------|
|                          | \$            | \$               |
| Prepaid                  | 90,966        | 195,350          |
| Other deposits           | 8,476         | 12,562           |
|                          | 99,442        | 207,912          |
|                          | \$            | \$               |
| Current prepaid expenses | 99,442        | 207,912          |
| Long-term lease deposits | 109,514       | 183,742          |
|                          | 208,956       | 391,654          |

### 6) INVENTORY

As at July 31, 2020, the Company had inventory totaling \$1,371,091 (January 31, 2020 – \$841,829), which consists of finished products such as recreational cannabis and accessories purchased from third parties for resale. During the and the three and six months ended July 31, 2020, \$2,763,856 and \$4,715,282, respectively, of inventory was recognized as cost of sales (three and seven months ended July 31, 2019 - \$562,214 and \$899,229, respectively). For the three and six months ended July 31, 2020, inventory was reduced by \$19,188 as a result of a write-down to net realizable value (July 31, 2019 - \$nil).



## KIARO BRANDS INC.

Notes to the Condensed Consolidated Interim Financial Statements

For the Six Months Ended July 31, 2020 and the Seven Months Ended July 31, 2019

(Expressed in Canadian Dollars)

### 7) INVESTMENTS IN MARKETABLE SECURITIES

On September 13, 2019, the Company and High Park Holdings Ltd. entered into a Subscription Agreement, pursuant to which, High Park Holdings Ltd., a wholly owned subsidiary of Tilray Inc. ("Tilray"), purchased from the Company an aggregate of 8,532,243 units of the Company by issuance of 128,670 class 2 common shares of Tilray. As part of the transaction, the Company granted 1,706,484 warrants to High Park. In March 2020, the Company sold the Tilray investment for net proceeds of \$910,183, resulting in a realized and recognized loss of \$2,105,548 and a realized foreign exchange gain of \$38,413. Summary for the six months ended July 31, 2020, is as follows:

|   |             |
|---|-------------|
|   | \$          |
| Balance, January 31, 2020                       | 2,986,518   |
| Net proceeds received from sale of investment   | (910,183)   |
| Interest and bank charges on sale of investment | (9,200)     |
| Realized loss on sale of investment             | (2,105,548) |
| Realized foreign exchange gain                  | 38,413      |
| Balance, July 31, 2020                          | -           |

### 8) LOAN RECEIVABLE

On June 19, 2019, the Company entered into a secured convertible debenture agreement with a third party, pursuant to which the Company lent \$300,000 to this party. The loan receivable had a maturity date of December 31, 2019, bore interest at 10% per annum, and was collateralized by 10,539,328 common shares in the capital of Pineapple Express Delivery Inc. ("Pineapple Express"), registered in the name of Mount Royal Investment Inc. ("MRI"), and 256,098 common shares in the capital of Namaste Technologies Inc. registered in the name of MRI. On July 31, 2020, the Company has settled the loan receivable for the amount of \$341,214, which included accrued interest of \$33,534. The Company settled the loan for \$35,000 cash, with the remaining loan balance being assigned to an entity controlled by the CEO of the Company, in exchange for the settlement of a convertible debenture issued to this entity controlled by the CEO of the Company with an equal principal balance of \$300,000 (Note 12(viii)). The Company recognized a loss on the settlement of this loan of \$5,344.

**KIARO BRANDS INC.**

Notes to the Condensed Consolidated Interim Financial Statements

For the Six Months Ended July 31, 2020 and the Seven Months Ended July 31, 2019

(Expressed in Canadian Dollars)

**9) PROPERTY AND EQUIPMENT**

|                                 | <b>Furniture and<br/>fixture</b> | <b>Computer<br/>equipment</b> | <b>Leasehold<br/>improvement</b> | <b>Software</b> | <b>Website</b> | <b>Total</b> |
|---------------------------------|----------------------------------|-------------------------------|----------------------------------|-----------------|----------------|--------------|
| <b>Cost</b>                     | \$                               | \$                            | \$                               | \$              | \$             | \$           |
| Balance at January 31, 2020     | 103,681                          | 191,817                       | 1,871,352                        | 103,085         | 52,763         | 2,322,698    |
| Additions                       | 2,127                            | 54,949                        | 426,329                          | 2,648           | 10,000         | 496,053      |
| Balance at July 31, 2020        | 105,808                          | 246,766                       | 2,297,681                        | 105,733         | 62,763         | 2,818,751    |
| <b>Accumulated depreciation</b> | \$                               | \$                            | \$                               | \$              | \$             | \$           |
| Balance at January 31, 2020     | 26,440                           | 85,381                        | 382,933                          | 50,216          | 28,656         | 573,626      |
| Depreciation and amortization   | 10,439                           | 47,757                        | 249,314                          | 17,984          | 15,608         | 341,102      |
| Balance at July 31, 2020        | 36,879                           | 133,138                       | 632,247                          | 68,200          | 44,264         | 914,728      |
| <b>Net book value</b>           | \$                               | \$                            | \$                               | \$              | \$             | \$           |
| Balance at January 31, 2020     | 77,241                           | 106,436                       | 1,488,419                        | 52,869          | 24,107         | 1,749,072    |
| Balance at July 31, 2020        | 68,929                           | 113,628                       | 1,665,434                        | 37,533          | 18,499         | 1,904,023    |

**KIARO BRANDS INC.**

Notes to the Condensed Consolidated Interim Financial Statements  
For the Six Months Ended July 31, 2020 and the Seven Months Ended July 31, 2019  
(Expressed in Canadian Dollars)

**10) RIGHT-OF-USE ASSETS AND LEASE LIABILITIES*****Right-of-use assets***

The following table illustrates the right-of-use asset balances during the period relating to retail spaces, offices, and warehouses:

|                                 | \$               |
|---------------------------------|------------------|
| <b>Cost</b>                     |                  |
| Balance at January 31, 2020     | 4,944,646        |
| Amendments                      | (304,554)        |
| Derecognition from sublease     | (41,843)         |
| Amortization                    | (427,436)        |
| <b>Balance at July 31, 2020</b> | <b>4,170,813</b> |

***Lease liabilities***

The following table illustrates the lease liabilities balances during the period relating to retail spaces, offices, and warehouses:

|                                 | \$               |
|---------------------------------|------------------|
| <b>Cost</b>                     |                  |
| Balance at January 31, 2020     | 3,171,100        |
| Payments net of interest        | (318,458)        |
| Amendments                      | (310,818)        |
| <b>Balance at July 31, 2020</b> | <b>2,541,824</b> |
| Current portion                 | 676,194          |
| Long-term portion               | 1,865,630        |

During the three and six months ended July 31, 2020, the Company recognized an interest expense on lease liabilities in the amount of \$116,654 and \$230,130 (three months and seven months ended July 31, 2019 - \$259,236 and \$363,653) in the condensed consolidated interim statements of loss and comprehensive loss.

The Company recognized cash outflow for leases of \$269,354 and \$512,382 for the three and six months ended July 31, 2020 (three and seven months ended July 31, 2019 - 790,322 and \$1,058,101) in the condensed consolidated interim statement of cash flows.

During the three and six months ended July 31, 2020, an amount of \$1,788 and \$55,210 (three months and seven months ended July 31, 2019 - \$17,110) was recognized for lease termination loss and loss on sub-lease for various lease agreements.

The company used a weighted average incremental borrowing rate of 17.95% at the date of the initial application.

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**10) RIGHT-OF-USE ASSETS AND LEASE LIABILITIES (continued)****Net investment in finance lease**

The Company has entered into third party sublease agreements. The Company's net investment in finance lease is presented in the condensed consolidated interim statements of financial position as follows:

|                                 | \$             |
|---------------------------------|----------------|
| <b>Cost</b>                     |                |
| Balance at January 31, 2020     | 591,391        |
| Additions                       | 82,756         |
| Amendments                      | (55,626)       |
| Interest accretion              | 48,854         |
| Lease receipts                  | (118,405)      |
| <b>Balance at July 31, 2020</b> | <b>548,970</b> |
| Current portion                 | 181,932        |
| Long-term portion               | 367,038        |

The lease liability is disclosed in Note 18 table for financial liabilities with contractual maturities information. The following table sets out a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis, reconciliation to the net investment in lease:

|   | \$             |
|---|----------------|
| Less than 1 year                              | 262,164        |
| 1 - 2 years                                   | 272,310        |
| 2 - 3 years                                   | 143,976        |
| > 3 years                                     | -              |
| Total undiscounted lease payments receivable  | 678,450        |
| Less: Interest accretion                      | (129,480)      |
| <b>Net interest in lease at July 31, 2020</b> | <b>548,970</b> |

**11) INTANGIBLE ASSETS AND GOODWILL**

|   | <b>Goodwill</b> | <b>Intangible assets -<br/>license</b> | <b>Total</b> |
|---|-----------------|--|--------------|
| Balance at January 31 and July 31, 2020 | 458,588         | 150,000                                | 608,588      |

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### 12) LONG-TERM LIABILITIES

|   | July 31, 2020 | January 31, 2020 |
|---|---------------|------------------|
|   | \$            | \$               |
| Promissory notes (i-iv)                     | 226,664       | 2,322,660        |
| Convertible debenture (v-viii)              | 5,701,847     | 4,208,107        |
| Canada Emergency Business Account Loan (ix) | 40,000        | -                |
|   | 5,968,511     | 6,530,767        |
| Current portion                             | 226,664       | 694,055          |
| Long-term portion                           | 5,741,847     | 5,836,712        |

- (i) During the period between October 17, 2019 and December 20, 2019, the Company entered into promissory note unit agreements (“Note Units”) with three companies related to directors of the Company totaling \$1,850,000. Each Note Unit consists of (i) one secured non-convertible note (“Notes”), bearing simple non-compounding interest at a rate of 14%, and is accrued and payable on the maturity date, and (ii) one share purchase warrant of the Company (totaling 3,052,500 warrants), exercisable at any time for a period of 2 years from the date of issuance and gives the holder the right to acquire one common share of the company at an exercise price of \$0.60 each (note 13). The Notes were to mature on the earlier of (i) 18 months following the date of issuance, and (ii) 5 days following the date on which the company sells or transfers the investment in Tilray shares (“Security”) to an arms-length third party, or otherwise disposed of the Security. The Note was secured against the Tilray shares the Company held (note 7) or the proceeds derived from the Company upon the sale of the Tilray shares. As a result of the loss from the sale of the marketable securities, the Company did use any of the proceeds to repay the Note Units. As at July 31, 2020, the Note Units were unsecured and the holders of the Note Units had agreed to not call for repayment for twelve months from January 31, 2020. On April 7<sup>th</sup>, 2020, one of the promissory notes with a face value of \$100,000 was settled for \$104,181 including accrued interest. On inception of the Note Units, the fair value of the debt component of \$1,707,094 was measured at the net present value of future cash flow using a discount rate of similar debt with no warrant attached. The residual value of \$142,907 was recorded in reserves as an equity component. The debt component was subsequently measured at amortized cost using an effective interest rate of 20%.
- (ii) On May 31, 2020, the Company settled the remaining portion of the Note Units (Note 12(i)) with three new convertible debentures totaling \$1,750,000 (Note 12(viii)), which has been accounted for as an extinguishment of debt and resulted in a loss on settlement of \$92,418.
- (iii) On October 18, 2019, pursuant to a purchase and sale agreement to acquire the right to lease from a third party (note 10), the Company issued an unsecured promissory note in the amount of \$600,000. The note had an interest rate of 10% per annum calculated from January 1, 2020 until April 1, 2020, at which time the note matured. The debt was settled on March 13, 2020, for \$613,644 including accrued interest.
- (iv) On June 9, 2020, the Company entered into a definitive agreement with DCA to combine the businesses of the two companies. The proposed transaction will be an arms’ length transaction, and, if completed, will constitute the Company’s “Qualifying Transaction” (as such term is defined in Policy 2.4 of the Exchange). Upon completion of the proposed transaction, the Resulting Issuer will carry on the business of Kiario. Furthermore, between June and July, 2020, DCA advanced to Kiario a loan of \$225,000 on commercial terms, with interest rates at 4% and maturing one year from the date of issuance.

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**12) LONG-TERM LIABILITIES** *(continued)*

Details of movements in the promissory note and unit balances is as follows:

|                                       | Promissory Note<br>Units | Promissory<br>Note | Total       |
|---------------------------------------|--------------------------|--------------------|-------------|
|                                       | \$                       | \$                 | \$          |
| Balance, January 31, 2020             | 1,722,660                | 600,000            | 2,322,660   |
| New promissory notes issued (iv)      | 225,000                  | -                  | 225,000     |
| Accretion of promissory notes         | 30,490                   | -                  | 30,490      |
| Net loss on settlement of debt        | 98,514                   | -                  | 98,514      |
| Settlement of promissory notes (ii)   | (1,750,000)              | -                  | (1,750,000) |
| Repayment of promissory notes (i,iii) | (100,000)                | (600,000)          | (700,000)   |
| Balance, July 31, 2020                | 226,664                  | -                  | 226,664     |

During the three and six months ended July 31, 2020, no interest payments were made, and \$122,586 and \$62,175 of interest payable on the promissory notes is recorded in accounts payable and accrued liabilities (three and seven months ended July 31, 2019 - \$nil).

- (v) During the period between May 19, 2019 and July 29, 2019, the Company closed three tranches of a non-brokered private placement of convertible debt for gross proceeds of \$4,250,000. In addition, on October 18, 2019, pursuant to a purchase and sale agreement to acquire the right to lease from a third party (Note 13), the Company issued convertible debt in the amount of \$1,000,000. Each convertible debenture matures two years from the closing date and bears interest at the rate of 8% per annum. The lenders may, at any time, convert all or a portion of the principal into common shares of the Company at a value being the lesser of \$0.432 per common share or the issue price of the Company's initial public offering, less a 20% discount. As the conversion price is variable, the conversion feature meets the definition of embedded derivative liability and was measured at fair value using level 3 inputs. Estimated probability and timing of conversion, and estimated benefit the holder will get from conversion were considered in determining the fair value of the conversion feature. The remaining portion, net of transaction costs of \$48,500, was allocated to the debt component.

As at July 31, 2020 and January 31, 2020, the conversion feature was remeasured at fair value, and the debt component was measured at amortized cost using effective interest rates of 22% - 24%.

- (vi) On February 1, 2020, the Company entered into an agreement with a third party for a convertible debenture in the amount of \$100,000. The convertible debenture bears interest at 8% and matures on February 1, 2022. The lender may, at any time, convert all or portion of the principal into common shares of the Company at a value of \$0.432 per common share. The Company recognized a derivative liability of \$24,281 on inception of the convertible debentures using an effective interest rate of 20%.
- (vii) On May 11, 2020, the company closed a non-brokered private placement of secured convertible debentures ("Debentures") for gross proceeds of \$1,000,000, with a maturity date of May 11, 2022 and a coupon rate of 10%. The Debentures were secured against the assets of the Company subject to subordination to third party lenders providing the Company operational financing. Each dollar of Debenture would convert to ten preferred shares and were issued together with five common share purchase warrants each exercisable to acquire one common share in the capital of the Company at an exercise price of \$0.13.

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### 12) LONG-TERM LIABILITIES (continued)

The warrants may not be exercised by the holder until after the earlier of: (A) the Company delivering written notice to the holder permitting such exercise; and (B) if the Company does not complete a Go-Public event by October 31, 2020. Should the Company not deliver notice permitting exercise and the Company completes a Go-Public event prior to October 31, 2020, the holder shall not have any opportunity to exercise the warrants. The Company has not delivered notice permitting exercise to the Debenture holder. The liability component is initially recognized at fair value, determined at net present value of future payments of interest and principal, discounted at the market rate for similar non-convertible liabilities at the time of issue (20%). The fair value of the liability component (\$672,869) is deducted from the face value of the instrument with the residual value (\$327,131) being allocated to the share conversion feature (\$228,892) and the warrant component (\$98,239) on a proportionate fair value basis. The residual value was calculated using the Black-Scholes model with a risk-free interest rate of 0.26%, a volatility of 100%, and an expected life of one year, and was initially recorded as shareholders' equity. At the shareholders meeting on July 7, 2020, the shareholders approved the Debentures converting into preferred shares of the company, at a rate of ten thousand common shares for each \$1,000 of principal amount of debentures, resulting in a deemed price of \$0.10 per preferred share. The secured convertible debentures did not accrue interest up to the date of the shareholders meeting. In addition, the preferred shares will be further convertible into common shares (subject to proportional adjustments for stock splits, stock dividends and alike) at any time up to the date of listing of the Company's common shares on any recognized North American securities exchange or stock market, including the Toronto Stock Exchange, the TSX Venture Exchange, or the Canadian Securities Exchange (the "Go-Public Event"). At the date of a Go-Public Event, any non-converted preferred shares will automatically convert into common shares at the applicable conversion ratio.

- (viii) On May 31, 2020, the Company issued three new convertible debentures totaling \$1,750,000 to companies related to a director of the Company. The convertible debentures bear interest of 8% and matures on May 31, 2022. The lender may, on the date of maturity, convert all, but not less than all, of the principal, all accrued and unpaid interest less applicable withholding taxes, into common shares of the Company at a deemed issue price of \$0.30 per common share. Subject to the Company going public, the holders have the option to convert all, but not less than all, of the principal, all accrued and unpaid interest less applicable withholding taxes, into common shares of the Company at a discounted go-public issue price equal to 80% of the issue price in connection with a go-public transaction. On July 31, 2020, one convertible debenture issued for \$300,000 was settled as part of the settlement of the Loan Receivable (Note 8), including accrued interest of \$4,332. A gain of \$4,418 was recorded on the settlement of this debt.

Details of movements in the convertible loan balance are as follows:

|  | Convertible<br>debenture | Derivative<br>liability | Total       |
|--|--------------------------|-------------------------|-------------|
|  | \$                       | \$                      | \$          |
| Balance, January 31, 2020                            | 4,208,107                | 1,285,000               | 5,493,107   |
| Convertible debt issued (vi-viii)                    | 2,360,467                | 459,515                 | 2,819,982   |
| Convertible debt settled (viii)                      | (229,720)                | (74,611)                | (304,331)   |
| Convertible debt converted to preferred shares (vii) | (1,000,000)              | -                       | (1,000,000) |
| Accretion of convertible debentures                  | 362,993                  | -                       | 362,993     |
| Change in fair value of derivative liability         | -                        | 25,883                  | 25,883      |
| Balance, July 31, 2020                               | 5,701,847                | 1,695,787               | 7,397,634   |

As at July 31, 2020, interest payable related to the convertible debentures of \$464,888 was accrued and included in the accounts payable and accrued liabilities.

Key assumptions that were used in the fair value of embedded derivative include the risk-free interest rate (0.29%). The change in fair value of embedded derivative liability of \$25,883 was recognized in the condensed consolidated interim statements of loss.

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### 12) LONG-TERM LIABILITIES (continued)

- (ix) On April 29, 2020, the Company entered into an agreement with a third party for a loan in the amount of \$40,000. The loan bears interest at 0% until December 31, 2022, and 5% thereafter from January 1, 2023 until the loan is repaid in full. The loan is to be repaid by interest only payments beginning on January 1, 2023, and the balance by December 31, 2025.

### 13) SHARE CAPITAL

#### Authorized

Unlimited number of common and preferred shares, without par value.

#### Issued

*During the period ended April 30, 2020:*

On February 1, 2020, Kiaro bought back and cancelled 500,000 shares, in exchange, the investor subscribed to a debenture equal to \$100,000 (note 12).

In February 2020, Kiaro issued 28,583 common shares at a price of \$0.586 per common share for services rendered.

*During the period ended July 31, 2020:*

On May 31, 2020, Kiaro issued 416,666 common shares at a price of \$0.1440 per common share for services rendered (Note 14).

On July 7, 2020, Kiaro issued 10,000,000 preferred shares for the conversion of convertible debentures issued May 11, 2020, in the amount of \$1,000,000. The preferred shares are non-redeemable, non-retractable, have voting rights and have first entitlement to any dividends or in the event of liquidation.

#### Options

The Company has adopted an incentive stock option plan, which provides that the Board of Directors of the Company may from time to time grant to directors, officers, employees and technical consultants to the Company options to purchase common shares, provided that the number of common shares reserved for issuance will not exceed 10% of outstanding common shares.

For the six months ended July 31, 2020, the Company recorded stock-based compensation of \$575,085 (seven months ended July 31, 2019 – \$68,289) for options vested.

The following table summarizes the movements in the Company's stock-options:

|                             | Options Outstanding | Weighted Average<br>Exercise Price |
|-----------------------------|---------------------|------------------------------------|
|                             | #                   | \$                                 |
| Balance at January 31, 2020 | 3,432,500           | 0.553                              |
| Granted                     | 825,000             | 0.459                              |
| Cancelled                   | (3,787,500)         | 0.550                              |
| Replaced                    | 3,837,500           | 0.213                              |
| Granted                     | 2,125,000           | 0.200                              |
| Forfeited                   | (800,000)           | 0.284                              |
| Balance at July 31, 2020    | 5,632,500           | 0.209                              |



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**13) SHARE CAPITAL (continued)**

In June, 2020, in efforts to align all previously issued options with the proposed qualifying transaction with DC Acquisition Corp. (Note 19), the Company cancelled and replaced all options with new options with an exercise price between \$0.20 and \$0.30. As the result for the replacement of new options, the incremental change to share-based compensation was \$26,196.

Details of options outstanding as at July 31, 2020 is as follows:

| <b>Expiry Date</b>              | <b>Weighted Average Remaining Life</b> | <b>Options Outstanding</b> | <b>Options Exercisable</b> | <b>Exercise Price</b> |
|---------------------------------|--|----------------------------|----------------------------|-----------------------|
|                                 | #                                      | #                          | #                          | \$                    |
| August 11, 2027 - July 31, 2030 | 9.36                                   | 5,132,500                  | 295,000                    | 0.20                  |
| September 25, 2029              | 9.16                                   | 500,000                    | -                          | 0.30                  |
|                                 | 9.34                                   | 5,632,500                  | 295,000                    |                       |

**Warrants**

The Company recorded \$65,219 in stock-based compensation for warrants during the six months ended July 31, 2020 (seven months ended July 31, 2019 - \$nil).

The following table summarizes the movement in warrants for the six months ended July 31, 2020:

| <b>Note</b>                 | <b>Warrants Outstanding</b> | <b>Weighted Average Exercise Price</b> |
|-----------------------------|-----------------------------|--|
|                             | #                           | \$                                     |
| Balance at January 31, 2020 | 9,214,198                   | 0.424                                  |
| Cancelled                   | (859,722)                   | 0.411                                  |
| Granted                     | 5,000,000                   | 0.130                                  |
| Balance at July 31, 2020    | 13,354,476                  | 0.240                                  |

Details of warrants outstanding as at July 31, 2020 is as follows:

| <b>Expiry Date</b>                   | <b>Warrants Outstanding</b> | <b>Warrants Exercisable</b> | <b>Exercise Price</b> |
|--------------------------------------|-----------------------------|-----------------------------|-----------------------|
|                                      | #                           | #                           | \$                    |
| May 11, 2023                         | 5,000,000                   | -                           | 0.130                 |
| November 6, 2020 - July 22, 2029     | 3,595,492                   | 1,068,058                   | 0.200                 |
| September 13, 2021                   | 1,706,484                   | -                           | 0.586                 |
| October 17, 2021 - December 24, 2021 | 3,052,500                   | -                           | 0.600                 |
|                                      | <b>13,354,476</b>           | <b>1,068,058</b>            |                       |

The weighted average remaining life for the warrants outstanding is 2.76 years.

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### 14) RELATED PARTY TRANSACTIONS

Related parties include the Company's key management personnel, independent directors and shareholders. Transactions with related parties were conducted in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and approved by the related parties.

The following table outlines key management personnel compensation for the three and six months ended July 31, 2020:

|                                   | Three months ended<br>July 31, 2020 | Three months ended<br>July 31, 2019 | Six months ended<br>July 31, 2020 | Seven months ended<br>July 31, 2019 |
|-----------------------------------|-------------------------------------|-------------------------------------|-----------------------------------|-------------------------------------|
|                                   | \$                                  | \$                                  | \$                                | \$                                  |
| Salaries and benefits             | 102,956                             | 96,547                              | 148,352                           | 312,811                             |
| Consulting fee                    | 75,000                              | -                                   | 120,000                           | -                                   |
| Share-based compensation          | 327,234                             | 26,202                              | 485,829                           | 50,817                              |
| Total key management compensation | 505,190                             | 122,749                             | 754,181                           | 363,628                             |

On February 14, 2020, the Company entered an unsecured \$500,000 short-term loan with the CEO of the Company. The loan bears interest of prime plus one percent per annum and is payable on demand. As of July 31, 2020, the loan had been fully repaid including accrued interest of \$4,571.

On May 31, 2020, Kiaro issued 416,666 common shares at a price of \$0.1440 per common share for services rendered to a Company owned by the CFO of the Company (Note 13).

During the period ended July 31, 2020, the Company settled two promissory notes issued to companies related to a director of the Company for \$1,000,000 and \$750,000 by converting the notes to convertible debentures (Note 12 (vii)). One of the debentures issued for \$300,000 was settled with the Loan Receivable (Note 8).

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### 15) SEGMENTED INFORMATION

Throughout the six months ended July 31, 2020, the Company operated in two segments:

- (i) Wholesale Cannabis Business - the Company owns and operates wholesale cannabis business through its wholly owned subsidiary National Cannabis Distribution Inc in the Province of Saskatchewan.
- (ii) Retail Cannabis Stores – The Company operates retail locations to sell and distribute cannabis and cannabis related products.

Corporate is not an operating segment and contains the Company's corporate, strategic, and administrative activities. All of the Company's revenue is earned and assets are located in Canada.

| <b>Six months ended July 31, 2020</b> | <b>Wholesale<br/>cannabis<br/>business</b> | <b>Retail<br/>cannabis<br/>stores</b> | <b>Corporate</b> | <b>Eliminations<br/>and<br/>adjustments</b> | <b>Total</b> |
|---------------------------------------|--|---------------------------------------|------------------|---|--------------|
| Revenue                               | 2,316,450                                  | 4,350,363                             | -                | -   | 6,666,813    |
| Intercompany revenue                  | 642,571                                    | -                                     | -                | (642,571)                                   | -            |
| Total revenue                         | 2,959,021                                  | 4,350,363                             | -                | (642,571)                                   | 6,666,813    |
| Cost of sales                         | 2,642,590                                  | 2,706,675                             | -                | (633,983)                                   | 4,715,282    |
| Gross profit                          | 316,430                                    | 1,643,688                             | -                | (8,588)                                     | 1,951,531    |
| Net profit (loss) for the period      | 138,178                                    | 19,953                                | (5,404,180)      | (8,588)                                     | (5,254,636)  |
| Total assets                          | 952,523                                    | 7,145,106                             | 1,856,156        | (8,588)                                     | 9,945,197    |

| <b>Six months ended July 31, 2019</b> | <b>Wholesale<br/>cannabis<br/>business</b> | <b>Retail<br/>cannabis<br/>stores</b> | <b>Corporate</b> | <b>Eliminations<br/>and<br/>adjustments</b> | <b>Total</b> |
|---------------------------------------|--|---------------------------------------|------------------|---|--------------|
| Revenue                               | 125,827                                    | 1,154,170                             | -                | -   | 1,279,997    |
| Intercompany revenue                  | 263,224                                    | -                                     | -                | (263,224)                                   | -            |
| Total revenue                         | 389,051                                    | 1,154,170                             | -                | (263,224)                                   | 1,279,997    |
| Cost of sales                         | 368,028                                    | 789,512                               | -                | (258,311)                                   | 899,229      |
| Gross profit                          | 21,023                                     | 364,658                               | -                | (4,913)                                     | 380,768      |
| Net loss for the period               | (64,498)                                   | (515,534)                             | (4,171,123)      | (4,913)                                     | (4,756,068)  |
| Total assets                          | 174,049                                    | 8,437,045                             | 2,848,659        | (4,913)                                     | 11,454,840   |

### 16) SUPPLEMENTAL CASH FLOW INFORMATION

Additional supplementary cash flow information is as follows:

|  | <b>6 months ended<br/>July 31, 2020</b> | <b>7 months ended<br/>July 31, 2019</b> |
|--|---|---|
|  | \$                                      | \$                                      |
| Interest paid                                | 17,825                                  | -                                       |
| Non-cash settlement on loan receivable       | 341,214                                 | -                                       |
| Non-cash settlement on convertible debenture | 300,000                                 | -                                       |

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### 17) COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company is party to litigation, the ultimate outcome of which cannot be reasonably estimated at this time. However, management's opinion is that the likelihood of any cash outflow as a result of these matters is remote, therefore, no amounts have been provided for in these condensed consolidated interim financial statements.

In May 2020, a lawsuit was filed against certain parties, including the Company, alleging that such parties were in breach of a lease agreement with the lessor. No estimate, at the date of the financial statements, could be made relating to any potential financial impact.

### 18) FAIR VALUE MEASUREMENT AND FINANCIAL INSTRUMENTS

The table below summarizes the carrying values of the Company's financial assets and financial liabilities:

|  | July 31 , 2020    | January 31, 2020  |
|--|-------------------|-------------------|
| Financial assets   | \$                | \$                |
| FVTPL  |                   |                   |
| Investments in marketable securities                           | -                 | 2,986,518         |
| Amortized cost   |                   |                   |
| Cash and cash equivalents                                      | 992,408           | 1,418,764         |
| Trade and other receivables (exclude GST receivable)           | 130,876           | 107,850           |
| Loan receivable  | -                 | 297,382           |
| Net investment in the lease                                    | 548,970           | 591,391           |
| <b>Total financial assets</b>                                  | <b>1,672,254</b>  | <b>5,401,905</b>  |
| Financial liabilities  |                   |                   |
| Financial liabilities at FVTPL                                 |                   |                   |
| Embedded derivative liability                                  | 1,695,787         | 1,285,000         |
| Financial liabilities at amortized cost                        |                   |                   |
| Accounts payable and accrued liabilities (exclude PST payable) | 1,845,342         | 1,438,865         |
| Due to related parties   | 1,246             | 18,861            |
| Purchase liabilities   | 296,315           | 473,410           |
| Lease liabilities  | 2,541,824         | 3,171,100         |
| Long-term liabilities  | 5,968,511         | 6,530,767         |
| <b>Total financial liabilities</b>                             | <b>12,349,025</b> | <b>12,918,003</b> |

#### Financial Risk Management Objectives and Policies

The Company manages its exposure to a number of different financial risks arising from its operations as well as its use of financial instruments including market risk, credit risk and liquidity risk through its risk management strategy. The objective of the strategy is to support the delivery of the Company's financial targets while protecting its future financial security and flexibility. Financial risks are primarily managed and monitored through operating and financing activities. The financial risks are evaluated regularly with due consideration to changes in the key economic indicators and up-to-date market information.

A summary of the Company's risk exposures as they relate to financial instruments is reflected below:

#### Market Risk

##### a) Currency risk

The Company does not operate outside of Canada and does not transact in foreign currency; therefore, the Company is not exposed to any inherent Currency risk.

## KIARO BRANDS INC.

Notes to the Condensed Consolidated Interim Financial Statements  
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### 18) FAIR VALUE MEASUREMENT AND FINANCIAL INSTRUMENTS (continued)

#### Liquidity Risk

##### b) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Cash bears interest at market rates. The Company's long-term liabilities with fixed rates of interest do not expose the Company to interest rate risk. The Company's long-term liabilities with an interest rate of prime rate plus a margin will be affected by fluctuations in the Canadian prime interest rate, which can have an impact on the interest expense recognized. The Company's long-term liabilities have fixed interest rates, and therefore the Company is not exposed to this risk.

##### c) Price risk

Price risk is the risk of variability in fair value due to movements in equity or market prices. The Company is currently not subject to price risk. In the prior year and until date of sale, the Company's investments in the marketable securities were susceptible to price risk arising from uncertainties about their future values. The fair value of these investments is based on quoted market prices which the shares of the investments can be exchanged for.

#### Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company manages liquidity risk by continuously monitoring forecasts and actual cash flows and taking the necessary actions to maintain enough liquidity for operations and for growth objectives.

As at July 31, 2020, the Company had \$992,408 in cash and cash equivalents (January 31, 2020 - \$1,418,764). The Company is obligated to pay financial liabilities with total carrying amounts and contractual cash flows amounting to \$3,045,833 in the next 12 months (January 31, 2020 - \$3,229,502).

As at July 31, 2020, the Company's financial liabilities have contractual maturities as summarized below:

|  | Due within<br>Less than 1<br>year | 1-2 years | 2-3 years | 3-4 years | > 4 years | Total        |
|--|-----------------------------------|-----------|-----------|-----------|-----------|--------------|
| Accounts payable and accrued liabilities (excluding PST payable) | \$ 1,845,342                      | \$ -      | \$ -      | \$ -      | \$ -      | \$ 1,845,342 |
| Due to related parties   | 1,246                             | -         | -         | -         | -         | 1,246        |
| Lease liability  | 676,194                           | 769,958   | 780,696   | 268,666   | 46,310    | 2,541,824    |
| Embedded derivative liability                                    | -                                 | 1,695,787 | -         | -         | -         | 1,695,787    |
| Purchase Liability   | 296,315                           | -         | -         | -         | -         | 296,315      |
| Long-term liabilities  | 226,664                           | 5,741,847 | -         | -         | -         | 5,968,511    |
| Total  | 3,045,761                         | 8,207,592 | 780,696   | 268,666   | 46,310    | 12,349,025   |

**KIARO BRANDS INC.**

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**18) FAIR VALUE MEASUREMENT AND FINANCIAL INSTRUMENTS (continued)****Liquidity Risk (continued)**

As at January 31, 2020, the Company's financial liabilities have contractual maturities as summarized below:

|  | Due within<br>Less than 1<br>year | 1-2 years        | 2-3 years      | 3-4 years      | > 4 years      | Total             |
|--|-----------------------------------|------------------|----------------|----------------|----------------|-------------------|
|  | \$                                | \$               | \$             | \$             | \$             | \$                |
| Accounts payable and accrued liabilities (excluding PST payable) | 1,438,865                         | -                | -              | -              | -              | 1,438,865         |
| Due to related parties   | 18,861                            | -                | -              | -              | -              | 18,861            |
| Lease liability  | 683,979                           | 781,753          | 908,122        | 624,239        | 173,007        | 3,171,100         |
| Embedded derivative liability                                    | -                                 | 1,285,000        | -              | -              | -              | 1,285,000         |
| Purchase Liability   | 370,180                           | 103,230          | -              | -              | -              | 473,410           |
| Long-term liabilities  | 694,055                           | 5,836,712        | -              | -              | -              | 6,530,767         |
| <b>Total</b>   | <b>3,205,940</b>                  | <b>8,006,695</b> | <b>908,122</b> | <b>624,239</b> | <b>173,007</b> | <b>12,918,003</b> |

**Credit Risk**

Credit risk arises from cash and cash equivalents held with banks, trade and other receivable (excluding GST receivable), and loan receivable. The Company does not have a significant concentration of credit risk with any customer and its maximum risk exposure is equal to the carrying value of the financial assets. The objective of managing credit risk is to prevent loss on financial assets. The Company minimizes credit risk as cash and cash equivalents are held by reputable financial institutions. The Company is not aware of any material collection issues. The Company applies the IFRS 9 simplified model of recognizing lifetime expected credit losses for all trade receivables as these items do not have a significant financing component. Trade receivables are written off when there is no reasonable expectation of recovery. The following table summarizes the Company's aging of trade and other receivables (excluding GST receivable) and expected credit losses as at July 31, 2020:

|              | Trade and other receivables<br>(excluding GST receivables) | Expected credit losses |
|--------------|--|------------------------|
|              | \$   | \$                     |
| 0 - 30 days  | 129,812  | -                      |
| 31 - 61 days | -  | -                      |
| 61 - 90 days | 179  | -                      |
| > 90 days    | 885  | -                      |
| <b>Total</b> | <b>130,876</b>   | <b>-</b>               |

## KIARO BRANDS INC.

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### 18) FAIR VALUE MEASUREMENT AND FINANCIAL INSTRUMENTS *(continued)*

#### Fair Value Measurement

The Company classifies its financial instruments using a fair value hierarchy as a framework for disclosing fair value of financial instruments based on inputs used to value the Company's investments. The hierarchy of inputs and description of inputs is described as follows:

Level 1 – Quoted market prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 – Unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

|  | <b>July 31, 2020</b> |         |           |           |
|--|----------------------|---------|-----------|-----------|
| <b>Fair value through profit or loss</b> | Level 1              | Level 2 | Level 3   | Total     |
|  | \$                   | \$      | \$        | \$        |
| Embedded derivative liability            | -                    | -       | 1,695,787 | 1,695,787 |
|  | -                    | -       | 1,695,787 | 1,695,787 |

For cash and cash equivalents, trade and other receivables (excluding GST receivable), loan receivable, accounts payable and accrued liabilities (excluding PST payable), and due to related parties, fair value approximates their carrying value at the year end due to their short-term maturities. For net investment in finance lease, purchase liability and long-term liabilities, fair value approximates their carrying value at the quarter end as the interest rates used to discount the host contracts approximate market rates.

### 19) SUBSEQUENT EVENTS

On May 6, 2020, the Company entered into an arms-length non-binding Letter of Intent (the "LOI") with DC Acquisition Corp. ("DC") to combine the businesses of the two companies. The LOI outlines the terms and conditions pursuant to which the Company and DC will complete a transaction that will result in a reverse take-over of DC by the Company (the "Proposed Transaction"). The Proposed Transaction will be an arm's length transaction, and, if completed, will constitute DC "Qualifying Transaction" (as such term is defined in Policy 2.4 of the TSX Venture Exchange (the "Exchange")). Upon completion of the Proposed Transaction, the resulting issuer (the "Resulting Issuer") will carry on the business of the Company, and intends to list as a Tier 2 industrial issuer on the TSX Venture Exchange. As at the date of the Condensed consolidated interim financial statements the Company anticipates to complete the Qualifying Transaction on or before September 30, 2020.